

FINANCIAL INSTITUTIONS COMMITTEE MEETING
Business Law Section, State Bar of California

Meeting of July 11, 2006

Committee Members Present: John Hancock, Chair; Meg Troughton, Vice Chair; Rosie Oda, Secretary; Michael Abraham; Bruce Belton; Leland Chan; Laura Dorman; Andrew Druch; Jim Dyer; Bart Dzivi; Rob Hale; Linda Iannone; Teryl Murabayashi; Brad Seiling; and Bob Stumpf.

Advisory Members and Others Present: Sally Brown; Gino Chilleri; John Drews; Elaine Lyndon; Bob Mulford; Michael Occhiolini; Steven Takizawa; Gerry Tsai; and Maureen Young.

Committee Members Absent: Mark Gillett; Jay Gould; Randy Kennon; Ken Krown; Rosemary Lemmis; Todd Okun; Allan Ono; Russ Schrader; Keith Ungles; and Richard Zahm.

Call to Order: Our Chair John Hancock of World Savings called the meeting to order at 9:35 A.M.

Welcome to Members and Advisory Members: John welcomed the Committee Members and the Advisory Members and asked each person to identify themselves and where they worked.

1. Approval of June 13, 2006 Minutes: The Committee approved the minutes of the June 13, 2006 meeting without objection.

2. OTS Preemption Determination Regarding Gift Cards: Meg Troughton, our Vice Chair, of Bank of America, reported on a June 9, 2006 preemption opinion of the OTS Chief Counsel on state gift card restrictions. The gift cards in question are open-loop, not limited to certain retailers, signature-based cards that do not have PINs that are not reloadable. She pointed out that this is an advantage to merchants because of the problems caused by theft of merchant terminals. The thrift is responsible for compliance with OFAC requirements for both the buyer and the recipient. Meg pointed out that not all banks agree that the BSA rules must apply to these types of cards. The preemption covered a number of possible state laws on licensing, disclosure requirements, fee restrictions, and expiration dates. By likening the card to a funds transfer and deposit account, she pointed out that the letter raised questions about whether reserve requirements were applicable. In general, she thought the letter was more detailed than necessary though we can all understand the need to cover preemption decisions very carefully.

3. Stolen Laptops: Meg also reported on a recent article in Business Week dated July 3, 2006 which took a more realistic look at identity theft. According the article, for all the drama over ID theft, it actually rarely results in actual financial loss. Although 4% of

Americans say they have been the victim of ID theft, only .09% actually had their data misused according to a study of four security breaches. Credit card fraud loss is actually down.

4. FFIEC Multifactor Authentication Requirements: Our Chair John Hancock of World Savings reported on the FFIEC's Guidance entitled "Authentication in an Internet Banking Environment." This concerns risks and risk reduction measures necessary to authenticate the identity of customers accessing Internet-based financial services. The Guidance requires that institutions identify risks and take mitigating steps, such as installing appropriate software, by the end of 2007. John reported that the e deadline may be difficult to meet. However, the regulators appear to be willing to provide some latitude in meeting that deadline. Authentication usually requires something you know (like a password), something you have (like an ATM card) or something you are (like a fingerprint). The Guidance is technology-neutral. For example, it allows institutions to track users online through an IP address or by cookies where that appropriately assists in authenticating the customer. For its risk assessment list, World graded the risk of each screen in its online banking application. Some institutions, like BofA, authenticate themselves to customers as part of this process, which helps reduce the likelihood of customers falling victim to a phishing attack.

5. Federal Communications Commission "Opt-out" Facsimile rule for Solicited Faxes: John reported on the FCC's final rule implementing the Junk Fax Prevention Act of 2005, 71 Fed. Reg. 25967 (May 3, 2006). He went over the rule, which basically prohibits sending unsolicited fax advertisements. The Commission expressly exempts "Established Business Relationships" from the prohibition, but the telephone fax number must be provided voluntarily by the recipient. All fax advertisements, whether or not unsolicited, must contain a notice on the first page stating that the recipient is entitled to request that the sender not send any future advertisements. "Advertisements" is broadly defined and includes things like mortgage rate sheets, which many would consider transactional faxes and not advertising. Thus, a mortgage lender must provide an opt-out message even if it faxes rate sheets only by specific request from mortgage brokers. John pointed out that there are unresolved issues of preemption and a lingering threat of a private right of action. Rob Hale of HSBC also warned that institutions take care in complying with this rule.

6. Credit Union Conversions to Banks: Rosie Oda of Pillsbury introduced this topic as one that is gaining momentum as a result of the recent "merger" application of Nationwide Credit Union into a bank subsidiary of its sponsor. There have also been several recent articles on the subject in the American Banker, which she distributed. Rosie briefly discussed the new proposed rules issued by the National Credit Union Administration on conversions, 71 Fed. Reg. 36946 (June 28, 2006), and gave an overview of conversion transactions. She also summarized the premise of Prof. Jim Wilcox's new book, Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms, which has been published by the Filene Institute, a credit union think tank. John Drews of DFI explained some of the differences between a credit union and a bank to those Committee members who were not familiar with credit unions. Rosie then

proposed that the Committee sponsor a program of interest to bank lawyers, bankers, and credit union management and lawyers on this topic. John called for a vote and the Committee agreed to sponsor the program.

Gerry Tsai of the FRB-SF, graciously offered to check whether the FRB-SF auditorium was available, since that would be neutral territory that might be more acceptable to credit unions than a bank auditorium. Leland Chan of the CBA said he would check whether someone at the CBA could speak, and Bart Dzivi said that he would ask whether anyone he knew on the Hill would be available for the panel. John said that Bar funds might be available to pay for their expenses. Rosie said she would contact the California Credit Union League to see if they would be interested in supplying a panel member.

7. State Legislative Report: Bob Mulford (now back at the FRB-SF) noted that our Legislature actually passed the budget within the Constitutional deadline. His handout was previously distributed by John, and Bob noted there was nothing to add beyond his extensive listing of new legislation.

8. Federal Legislative Report: Bart has provided us with a copy of the Regulatory Relief legislation, S. 2856, and the accompanying Senate report. The Senate bill is narrower than the House bill, which has also passed. The most notable provision is the process established for resolution of issues surrounding the definition of a “broker” under the Exchange Act. Section 101 of the Senate bill would set up a “meet and confer” process between the banking agencies and the SEC, create special judicial review of the SEC’s decision, and expressly remove *Chevron* deference of the SEC’s decision. Section 212 of the House bill increases the existing limits on business loans for S&Ls. This provision has become controversial because credit unions desire a similar increase in the Credit Union Regulatory Improvement Act, which will not be adopted this year.. Privately insured credit unions will have the opportunity under section 301 of the House bill to become members of the Federal Home Loan Banks. Rosie pointed out that Patelco Credit Union, the largest privately insured credit union, is located in California. The House bill includes an anti-Wal-Mart provision at section 404 which prohibits interstate branching of any industrial loan corporation where the holding company generates more than 15% of income from nonfinancial activity, and it only applies to ILC created after October 1, 2003.

. At the end of the session, legislators will huddle and try to get the legislation passed by unanimous consent (which would be a handshake deal), not requiring an identifying vote. This is Oxley’s and Sarbanes’ last chance to leave their thumbprint on history. Bart warned that section 702 of the Senate bill gives the banking agencies, and receiver/conservators, the power to enforce written conditions or written agreements against institution affiliated persons. The purpose of this new language is to broaden authority of regulators to enforce capital commitments against directors and major shareholders.

Bart also commented that the Administration might soften its position on legislation on government sponsored enterprises now that a new Director of OFHEO has been appointed.

9. National Security Letters under the USA PATRIOT Act: Maureen Young of Bingham McCutcheon reported that banks have been receiving national security letters (“NSLs”) calling into question financial institution practices, and complying with them without question. She warned that when a government investigator comes requesting documents, a financial institution must insist on legal process. What has happened to the telecom companies is an example. There have always been some exceptions to the Right to Financial Privacy Act, but nothing applies to intelligence agencies, and that is the basis for the NSL letters. Banks should ensure that legal process is followed when served with such letters. She cautioned that as few people in the bank as possible should know what has been requested. With reauthorization of the Patriot Act, a process has been adopted, and you have to go through a court hearing.

10. Adjournment: The meeting was adjourned at 11:00 a.m.